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IN THE

# Supreme Court of the United States

October Term, 1942.

No. 116

LANE-WELLS COMPANY, a corporation, and TECHNICRAFT ENGINEERING CORPORATION, a corporation,

*Petitioners,*

*vs.*

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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IN THE

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*Petitioners,*

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COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Lane-Wells Company, a corporation, and Technicraft Engineering Corporation, a corporation, as your petitioners respectfully pray that a Writ of Certiorari issue to review a judgment entered March 22, 1943, in the United States Circuit Court of Appeals for the Ninth Circuit, in case No. 10183 entitled, "Lane-Wells Company, a corporation, and Technicraft Engineering Corporation, a corporation, Petitioners, vs. Commissioner of Internal Revenue, Respondent." There were originally two cases, but the same were consolidated in the Circuit Court inasmuch as they involved the same facts, and the matters were separate only because there was an assessment against Lane-Wells Company as transferee of Technicraft Engineering Corporation. It will serve the purposes of convenience of this Honorable Court that the cases continue to be treated as consolidated.

## Questions Presented.

1. May the Circuit Court of Appeals affirm a decision of the Tax Court of the United States (formerly the United States Board of Tax Appeals) on the ground that there was substantial evidence to support the decision of the Tax Court, and in support of such action rely upon a conclusion of law rather than a finding of fact?

2. Where the evidence of the taxpayer in the hearing before the Tax Court of the United States proceeds on the legal conclusion that all of the income of such taxpayer was not royalty income within the meaning of the Personal Holding Company Act, and where the decision of the Tax Court, which is affirmed by the Circuit Court of Appeals, adopts a distinction as to portions of that income, would not the accepted and usual course of judicial proceeding require the matter to be remanded to the original trial court for the purpose of permitting the taxpayer to introduce the evidence segregating the income in accordance with the principals determined upon by the Tax Court and affirmed by the Circuit Court of Appeals?

3. Where the findings of the Tax Court are of pure fact, and sustained by substantial evidence, may the Circuit Court of Appeals, in affirming the Tax Court, reverse such findings?

## Statement.

Briefly stated, the facts upon which the foregoing questions arose are as follows: The Commissioner contends that during the calendar years 1934, 1935 and 1936, Technicraft Engineering Corporation (hereinafter referred to as Technicraft) was a personal holding company within the meaning of that term as defined by Section 351 of the Revenue Act. At all times herein involved, all of

the corporate stock of Technicraft was owned in equal amounts by four persons, to-wit, W. G. Lane, Hazel T. Lane (husband and wife) and Walter T. Wells and Mary P. Wells (husband and wife). Technicraft was one of five corporations, the stock of each of which was held in the same manner and in its entirety by Messrs. Wells and Lane and their respective wives [Tr. 150, 151, 164]. At all times herein involved, all of these corporations, with the exception of Technicraft, were engaged in the performance of various skilled, technical services in the oil industry, particularly the service of gun perforating [Tr. 151, 152]. In addition to such rendition of services, all of these related corporations (except Technicraft) were engaged also in the manufacture and sale of various products used in the oil industry [Tr. 152]. At all times after March, 1934, at which time it commenced business operations, Technicraft was engaged in engineering, research, and development work [Tr. 151, 158, 160, 161, 162, 170, 171, 173, 179, 117].

When the business of their corporations was first launched, Messrs. Wells and Lane, both of whom were engineers, were cognizant of the necessity of keeping abreast with scientific developments in the oil industry as essential to the success of an oil service business [Tr. 164, 165]. In December of 1932 they acquired an exclusive license to a patent from one, Sidney Mims [Tr. 118], which patent had been issued in the year 1926 and had never proven itself commercially practicable [Tr. 154, 156, 157, 163, 171, 172, 173, 175, 178]. Foreseeing the need of scientific research and development on the process of gun perforating, which Mims had sought to develop, and seeing also the need of extensive scientific research and development on various other devices and processes

in order to build a successful oil service business, Messrs. Wells and Lane, in December of 1932, agreed that they would set aside 15% of all their income from gun perforating, which 15% would be used to carry on the research, engineering and scientific development of Technicraft [Tr. 164, 165]. Accordingly, Technicraft became a "laboratory" wherein patents or new processes or devices were secured, developed and passed on to the other Lane-Wells companies, which were engaged in services, manufacture and sale [Tr. 158]. In order to provide a convenient method of collecting the 15% of gun perforating income which was to constitute the research fund to be used by Technicraft for the benefit of the various Lane-Wells companies, license agreements were issued from Technicraft to Lane-Wells Company, a California corporation, Lane-Wells Co. of Oklahoma, an Oklahoma corporation, and Lane-Wells Co. of Texas, a Texas corporation [Tr. 165, 166]. It was not the intention of the persons involved that these be true license agreements, but rather than that, the execution of the license agreements constituted a bookkeeping means of providing Technicraft with reimbursement for engineering services rendered [Tr. 171, 173, 176, 261]. The 15% gun perforating income was collected from Lane-Wells Co. of Oklahoma and Lane-Wells Co. of Texas, and the entire system of engineering, research and development continued even after the license agreements had expired in February of 1937 [Tr. 166]. Lane-Wells International, Inc., another of the related Lane-Wells companies, and which was organized in 1936, received the benefits of engineering development by Technicraft and paid 15% of its income, even without going through the formality of execution of a similar license agreement [Tr. 166].

As a result of scientific development and engineering research by Technicraft, gun perforating, which had been commercially impracticable under the Mims patent, became a very successful and profitable business [Tr. 178]. In addition to the developments in gun perforating, Technicraft engineers explored new fields of endeavor in the oil industry and developed and patented many new products, such as fishing magnets [Tr. 162], packers [Tr. 176, 177], bridging plugs [Tr. 180], packing glands, etc. [Tr. 158], and many new services such as Stratagraph [Tr. 160, 161], ex-raying of cable [Tr. 160], underground surveys, etc., all of which were passed on without any further charge to the various Lane-Wells companies [Tr. 166]. Technicraft was not a mere depository for patents, but on the other hand, occupied a large building designed for engineering purposes, in which it carried on extensive and elaborate engineering functions [Tr. 159, 162]. It had on its payroll many experienced engineers [Tr. 179].

The Commissioner contends that Technicraft's income was royalty income within the meaning of the Personal Holding Company Act. The taxpayer contends that form must give way to substance and that the income which Technicraft received as compensation for engineering services is not "royalty" income merely because it was paid through the artificial arrangement of patent license agreements.

The Circuit Court of Appeals for the Ninth Circuit affirmed the decision of the Tax Court on the ground that said court "could reject the testimony of the prior agreements that the furnishing of these patents and models and mechanical devices or processes were mere professional engineering services paid for by the 15% of gross income." The Circuit Court also held that "* * * if,

in addition to the licensed matter, non-royalty devices were given for the same 15% consideration, there was no segregation to show that they amounted to over 20% of the taxed income." In the first instance, the Circuit Court ignored the fact that the Tax Court did not "reject" the testimony of the prior agreements, but, on the contrary, by its express findings, recognized the existence of a prior agreement that the furnishing of the patents and models and mechanical devices and processes were mere professional engineering services paid for by the 15% gross income. Apparently the Circuit Court mistook the Tax Court's conclusion of law to the effect that the income was royalty income for a finding of fact. In the second instance, by its decision, the Circuit Court of Appeals defeated the ends of justice by not affording to the petitioners, by proper remand to the Tax Court of the United States, an opportunity to evidence the segregation between the sources of income that would reveal that unquestionable non-royalty income sources constituted more than 20% of the petitioners' taxed income. It is in consequence of said judgment and act of said Circuit Court of Appeals that your petitioners seek review by certiorari in this Honorable Court to determine that a litigant's rights may not be summarily destroyed by the failure of a Circuit Court to distinguish between findings of fact and conclusions of law; and to determine also that where a case has not been adequately tried so as to cover issues developed for the first time on appeal therefrom, that said matter should be remanded so that a litigant may enjoy his day in court on all issues properly presented to the trial court.

## Reasons Relied Upon for the Allowance of the Writ of Certiorari.

It is respectfully submitted by your petitioners and relied upon as reasons for the granting of the writ that:

1. The act of the Circuit Court of Appeals for the Ninth Circuit in confusing findings of fact and conclusions of law has the effect of being a departure so far from the accepted and usual course of judicial proceeding as to call for an exercise of this Court's power of supervision.

2. The act of the Circuit Court of Appeals in assuming that the Tax Court had rejected testimony, when in fact the Tax Court had based its findings upon the truth of such testimony, is of such materiality as to leave the decision of the Circuit Court without any support whatsoever.

3. The decision of the Circuit Court of Appeals upholds a decision of the Tax Court of the United States, which is based upon the theory that the petitioners should have introduced evidence segregating classes of income, and justice would require the matter to be remanded to the Tax Court so that evidence of such segregation could be presented to the Tax Court for consideration.

4. The decision of the Circuit Court of Appeals has the effect of reversing the findings of fact of the Tax Court despite the fact that such findings are of pure fact and are supported by substantial and competent evidence. In reversing the findings of the Tax Court, that are supported by competent evidence, the Circuit Court has adopted a procedure in conflict not only with its own decisions, but the decisions of other Circuit Courts and the controlling decisions of the United States Supreme Court.

Wherefore, your petitioners respectfully pray that a Writ of Certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Ninth Circuit, directing that Court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket as No. 10183, "Lane-Wells Company, a corporation, and Technicraft Engineering Corporation, a corporation, Petitioners, vs. Commissioner of Internal Revenue, Respondent," and that the judgment of said Court be reversed by this Honorable Court and that your petitioners may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

June, 1943.

RAPHAEL DECHTER,
*Counsel for Petitioners.*

HARRY A PINES,
*Of Counsel for Petitioners.*

IN THE

# Supreme Court of the United States

October Term, 1942

No.....

LANE-WELLS COMPANY, a corporation, and TECHNICRAFT ENGINEERING CORPORATION, a corporation,

*Petitioners,*

*vs.*

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

## BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

### Opinion Below.

The findings of fact and the opinion of the Tax Court of the United States (formerly the Board of Tax Appeals) are reported in 43 B. T. A. 463. The opinion of the United States Circuit Court of Appeals for the Ninth Circuit was filed March 22, 1943, and is reported in 134 Fed. (2d) 977.

### Jurisdiction.

The judgment of the Circuit Court of Appeals was filed on March 22, 1943, at which time a petition for rehearing was denied. This petition for Writ of Certiorari is filed within three months after the filing of the judgment of the Circuit Court of Appeals for the Ninth Circuit.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, 28 U. S. C. A. 347.

## Statement of the Case.

The essential facts of the case herein are stated in the accompanying petition for Writ of Certiorari and in the interests of brevity are not repeated herein.

## Specification of Errors.

The Circuit Court of Appeals erred in each of the following particulars:

1. In holding that petitioners' income was royalty income, when by doing so it erroneously held itself bound by a conclusion of law, which it assumed was a finding of fact.

2. By not affording the taxpayer an opportunity to introduce the evidence of segregation indicated in both the decision of the Tax Court and the Circuit Court of Appeals, by proper remand to the Tax Court of the United States.

3. In effectually reversing findings of the Tax Court, which findings are of pure fact and supported by substantial evidence, and which findings compel a conclusion of law different from that to which the Court arrived in this case.

## Argument and Authorities in Support of Petition for Writ of Certiorari.

It is petitioners' contention that despite the fact that there was the use of the words "license agreement", "royalty", "licensor" and "licensee", in tax matters form must give way to substance. The income in this case was the result of moneys set aside by affiliated companies of Technicraft for the purpose of paying Technicraft to carry on the research and development upon which these affiliated companies depended. There is no contradiction

in the evidence that this was the case. The payments were made pursuant to an agreement by Mr. Wells and Mr. Lane (who owned and controlled the various Lane-Wells companies) that 15% of the gross business of these companies would be set aside to pay for engineering, research and development. As to this evidence, the Circuit Court of Appeals said, "Obviously, the Board could reject the testimony of the prior agreements that the furnishing of these patents and models and mechanical devices or processes were mere professional engineering services paid for by the 15 per cent of gross income." Whether the Tax Court could have rejected such testimony or not, the fact of the matter is that *it did not reject such testimony.* We refer to the findings of fact of the Tax Court, from which we quote as follows: "When the original exclusive license agreement was made with Mims by the Lane-Wells Co. of California on December 21, 1932, Lane and Wells agreed between themselves to set aside 15 per cent of the income of the Lane-Wells Co. of California for research and development" [Tr. 59]. Here we find that the Tax Court did not reject the testimony as to such agreement, but definitely found such agreement to be a fact. Hence, it is obvious that the Circuit Court of Appeals has either (1) overlooked the record, or (2) undertaken to ignore it. In either particular, such action by the Circuit Court of Appeals constitutes a departure from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

By ignoring the findings of fact by the Tax Court, the Circuit Court is in conflict with its own former decision in *Commissioner v. Cecil B. DeMille etc.*, 90 Fed. (2d) 12, wherein it held that the findings of the Board of Tax Appeals are conclusive if (1) based upon pure fact, and

(2) sustained by any substantial evidence. This decision was predicated upon the decision of this Court in *Elmhurst Cemetery Co. of Joliet v. Commissioner,* 300 U. S. 37, 81 L. ed. 491, 57 S. Ct. 324. It is without question that the Circuit Court of Appeals has no power to make an independent determination of the matters which were in issue before the Tax Court. *Helvering v. National Grocery Co.,* 304 U. S. 282, 82 L. ed. 1346. The Circuit Court does not have the power to make its own findings of fact and it may not substitute its view of the facts for that of the Tax Court. *Helvering v. Rankin,* 295 U. S. 123, 79 L. ed. 1343, 55 S. Ct. 732. See also the very recent decision of this Court in *Wilmington Trust Co. (ex Ortiz) v. Helvering,* 316 U. S. 164, 62 S. Ct. 984, 86 L. ed. 1352.

The evidence in this case reveals that all of the income of Technicraft derived from 15% of the gross income of its affiliated companies was for engineering services rendered. In its decision, the Tax Court of the United States indicated that the taxpayer had failed to segregate portions of that 15% that may have been attributable to engineering services from those portions which are attributable to the use of patents. By its decision in the case of *U. S. Universal Joints Co. v. Commissioner,* 46 B. T. A. 15, the Tax Court revealed that had such a segregation been made, its conclusions would have been different. Before the Circuit Court of Appeals, the taxpayer called that Court's attention to the fact that no such segregation was made in the hearing before the Tax Court for the reason that 100% of the 15% of the gross income of the affiliated companies was attributable to engineering services, the same having been paid in pursuance of the agreement between Mr. Wells and Mr. Lane, which the

Tax Court found had taken place on December 12, 1932 [Tr. 59]. Nevertheless, the taxpayer urged that in any event it should at least be afforded a further hearing before the Tax Court so as to enable it to show such a segregation, based upon the reasonable value of the engineering services as distinguishable from the reasonable value of the use of patents. This request was ignored by the decision of the Circuit Court of Appeals in its affirmation of the decision of the Tax Court. By this action, the taxpayer is precluded from presenting evidence which, in the case of *U. S. Universal Joints Co. v. Commissioner, supra*, had the effect of avoiding a personal holding company status for the taxpayer. It will be apparent to the Court that the petitioner, Technicraft, was not an "incorporated pocketbook" as contemplated by Congress in the enactment of the Personal Holding Company Act. It will further be apparent, even from the briefs of government counsel that Technicraft is the unfortunate victim of technical construction of the Act. Justice is not served in this case unless petitioners are enabled to present the evidence of segregation that the decisions of the Tax Court and the Circuit Court of Appeals have indicated, and thus avoid the harsh results of a personal holding company status. Failure on the part of the petitioners to introduce evidence of such segregation is not due to negligence or laches of any sort. As a matter of fact the record reveals that the value of the patent licenses themselves was no more than $200.00 per month [Tr. 177]. The taxpayer did not introduce additional such evidence because it conscientiously and honestly considered 100% of its income as the result of engineering services, and therefore saw no propriety in artificially apportioning or segregating such income.

We appreciate the conditions under which certiorari may be granted by this Honorable Court. In this particular case, there has been so drastic a departure from usual accepted processes of judicial administration as to warrant the intervention and supervision of this Court. Petitioners diligently presented all of the facts to the Tax Court. The Tax Court found petitioners' evidence to be true and based its findings accordingly. As a conclusion of law, the Tax Court held that the income was royalty income despite its finding that the income was paid under agreement to provide for engineering services. In reviewing the matter, the Circuit Court of Appeals ignored the findings of fact of the Tax Court and affirmed the decision of the Tax Court by citing a conclusion of law of the Tax Court as a finding of fact. In addition, the Circuit Court of Appeals has closed the door to petitioners' opportunity to introduce additional evidence that would clearly reveal that it was not a personal holding company within the meaning of that term as defined by section 351 of the Revenue Act of 1936. We respectfully pray that this Honorable Court take jurisdiction in the premises.

June ....., 1943.

RAPHAEL DECHTER,
*Counsel for Petitioners.*

HARRY A. PINES,
*Of Counsel for Petitioners.*

# In the Supreme Court of the United States

OCTOBER TERM, 1943

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No. 116

LANE-WELLS COMPANY, A CORPORATION, AND TECHNICRAFT ENGINEERING CORPORATION, A CORPORATION, PETITIONERS

*v.*

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT*

---

## MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The petition in this case should be considered in conjunction with the Government's petition in *Helvering* v. *Lane-Wells Company*, No. 115. Each petition seeks review of the same judgment, which was partly in favor of the Government and partly in favor of the taxpayer.[1]

---

[1] The taxpayer, Technicraft Engineering Corporation, a California corporation, had transferred all its assets in 1937 to the petitioner Lane-Wells Company, and it has been stipulated (R. 65) that the latter is liable as transferee for any taxes which may be found to be due from Technicraft.



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The Commissioner had determined that the taxpayer corporation was liable for the additional corporate tax imposed upon personal holding companies by the Revenue Acts of 1934 and 1936. He also ruled that the taxpayer was subject to the 25% penalty for failure to file personal holding company returns on Form 1120 H, as required by the Treasury Regulations. The taxpayer challenged the Commissioner's determination in the Board of Tax Appeals, *inter alia*, upon the following grounds: (a) that it was not a personal holding company within the meaning of the statute, and therefore was not liable at all for personal holding company taxes; (b) that, in any event, even if it were a personal holding company, the regular corporate returns which it had filed on Form 1120 were sufficient to relieve it of the 25% penalty; and (c) that the filing of the returns on Form 1120 was sufficient to start the running of the statute of limitations in its favor, with the consequence that all liability was barred as to at least one of the years involved, 1934.

The Board decided each of these three questions adversely to the taxpayer. The Circuit Court of Appeals affirmed the Board on the first question, agreeing that the taxpayer was a personal holding company subject to tax as such. It ruled, however, that the returns which had been filed on Form 1120 were sufficient to relieve the taxpayer of the penalty and were sufficient to start the run-

ning of the statute of limitations in the taxpayer's favor.

The Government's petition for certiorari seeks review of the rulings below on points (b) and (c). As to that portion of the decision below there is a square conflict, for it has been held in other circuits that the failure to file a return on Form 1120 H is not overcome by the filing of a return on Form 1120. There is, however, no conflict whatever with respect to the separate question raised by the petition herein, as to whether the taxpayer was a personal holding company. That question was correctly decided by both the Board and the court below upon the basis of the peculiar facts in this record, and does not call for review by this Court.

Section 351 (b) (1) of the Revenue Act of 1934 requires, *inter alia,* that a corporation receive "at least 80 per centum of its gross income * * * from royalties, dividends, interest, annuities, and * * * gains from the sale of stock or securities," in order that it may be classified as a personal holding company. The question herein is whether certain amounts received by the taxpayer from other corporations constitute "royalties." It is not contested that those amounts exceeded 80% of its income, so that if they are to be treated as "royalties," there is no dispute that the taxpayer was a personal holding company. The taxpayer owned various patents and processes and

it had entered into arrangements with certain related corporations whereby it received 15% of their gross receipts for the use of these patents and processes. Such formal documents as set forth the arrangements between the taxpayer and the other corporations explicitly referred to these payments as "royalties." There was ample evidence to support the Board's determination that these payments were royalties, and the question is certainly not one for further review here.

The petition should be denied.

Respectfully submitted,

OSCAR COX,
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SAMUEL O. CLARK, JR.,
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JULY 1943.

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